FACT SHEET: Administration's FY2015 Budget Tax Proposals

Today, the U.S. Department of the Treasury released the General Explanations of the Administration's FY2015 Revenue Proposals, known as the "Greenbook," which explains the Administration's revenue proposals included in the President's 2015 Budget.

View the full Greenbook here.

The FY2015 Greenbook Includes Key Policies to:

EXPAND EARNED INCOME TAX CREDIT (EITC) BENEFITS FOR WORKERS WITHOUT QUALIFYING CHILDREN, FAMILIES WITH MORE THAN TWO CHILDREN AND MARRIED COUPLES

The EITC is among the Nation's most significant tools for reducing poverty and encouraging people to enter the workforce. Workers without qualifying children, however, miss out on these anti-poverty and employment effects of the EITC. The President has proposed to address these problems with the current childless worker EITC by doubling the maximum credit to about $1,000 and increasing the income level at which the credit is fully phased out to about $18,000 (roughly 150 percent of the Federal poverty line for a single adult). The proposal would also make the credit available to young adult workers age 21 and older and would raise the EITC's upper age limit from 65 to 67, harmonizing it with the recent and scheduled increases in the Social Security full retirement age.

The budget also permanently expands the EITC for families with more than two children and married couples. Families with more than two children face higher costs and have higher poverty rates than smaller families but until 2009 were not eligible for additional help from the EITC. The American Recovery and Reinvestment Act increased the maximum EITC for these families, while also expanding EITC eligibility for married couples to reduce EITC marriage penalties. These changes will benefit about six million working families in 2015.

LEVEL THE PLAYING FIELD BY MODERNIZING U.S. TAX RULES SO THAT MULTINATIONAL FIRMS PAY THEIR FAIR SHARE

Every year, multinational firms avoid billions of dollars in U.S. taxes through accounting maneuvers or other loopholes that shift profits to low-tax countries or create "stateless" income that goes untaxed everywhere in the world. These gimmicks often exploit the unintended consequences of a tax code that was not written with the 21st century economy in mind. The President remains committed to working with Congress to stop these abuses, and the Budget builds on prior-year proposals with new reforms to modernize the U.S. international tax system to: protect the U.S. tax base from excessive interest deductions by U.S. and foreign multinationals; restrict the ability for multinationals to create "stateless income;" and provide updated rules for transactions in digital goods and services by foreign subsidiaries. For further detail on these proposals, see "Reduce Incentives to Shift Income and Assets Overseas" below.

CLOSE LOOPHOLES THAT ALLOW PROFESSIONAL SERVICES BUSINESSES TO AVOID SELF-EMPLOYMENT PAYROLL TAXES

This loophole has garnered attention in recent years after being exploited by some taxpayers to avoid paying Medicare payroll taxes on earnings by establishing S-corporations and treating only a portion of their total earnings as taxable wages. The Administration proposes to tax owners of these pass-through businesses providing professional services consistently, regardless of the legal form of the organization.

SUPPORT STUDENTS BY EXCLUDING PELL GRANTS FROM INCOME AND FROM EDUCATION TAX CREDIT CALCULATIONS

Nearly all of the approximately nine million Pell grant recipients would benefit from the proposal to exclude Pell grants from income and from the calculation of the American Opportunity Tax Credit (AOTC). This proposal will reduce tax burdens (or increase the AOTC) for many of these recipients, and will simplify the taxation rules regarding Pell grants and the AOTC.

SUPPORT MIDDLE CLASS FAMILIES

Make the AOTC permanent. Currently authorized through 2017, the AOTC provides taxpayers a credit of up to $2,500 per eligible student per year for qualified tuition and related expenses paid for each of the first four years of the student's post-secondary education. The AOTC benefits about 11.5 million families, who have an average benefit of more than $1,100 per family.

Permanently expand the Child Tax Credit available to working parents with low earnings. In the absence of the Recovery Act improvements, working parents with earnings below about $14,000 would not be eligible for the Child Tax Credit in 2015, and a single parent with two children would need earnings of about $25,000 to benefit in full (a married couple would need earnings close to $28,000). The Recovery Act extended eligibility for the Child Tax Credit to working parents with low earnings, providing about 12 million working families with an average benefit of about $900 per family in 2015.

Increase the Child and Dependent Care Tax Credit (CDCTC). The Budget would increase the amount of tax credits for moderate income families with young children who pay for child care. About 1.7 million families would benefit from the CDCTC expansion in 2015, with an average tax cut of $619 in 2015.

Provide for automatic enrollment in individual retirement accounts (IRAs). This proposal will improve retirement security for millions of workers by requiring employers with more than 10 employees that have been in business for at least two years and that do not offer a retirement plan, to automatically enroll employees in an IRA. With an automatic IRA, retirement savings are deducted from each paycheck and deposited in the worker's own account. Employees can opt out of the program or change the amount of their contributions at any time. Participating small employers would be eligible for a tax credit for up to six years. About 13 million workers would begin contributing to retirement savings through auto-IRAs as a result of this proposal.

Extend the exclusion from income for cancellation of certain home mortgage debt. Although there has been improvement in the residential real estate market, an elevated number of homeowners still may have discharges of indebtedness income with respect to their home mortgage loans. As a result of the continued importance of facilitating home mortgage modifications, the Administration believes the exclusion should be extended. This will also retroactively extend the exclusion for three years, to cover amounts discharged before January 1, 2017.

<u>JUMPSTART GROWTH</u>

Designate 20 "Promise Zones" to promote job creation and investment. The Administration proposes to designate 20 Promise Zones, 14 in urban areas and six in rural areas, inclusive of the five promise zones designated earlier this year. Promise Zones would promote job creation and investment in economically distressed areas.

Create a new, permanent America Fast Forward (AFF) Bonds Program. The proposal would create a new, permanent AFF Bond that would be an alternative to traditional tax-exempt bonds, and a replacement of the Build America Bonds (BABs) program. Like BABs, AFF Bonds would be taxable bonds issued by state and local governments in which the federal government makes direct payments to state and local governmental issuers. The subsidy rate would be 28 percent, which is approximately revenue neutral in comparison to the Federal tax losses from traditional tax-exempt bonds.

Repeal fossil fuel tax breaks and provide incentives for renewable energy and energy efficiency. The fossil fuel preferences that the Administration proposes to repeal encourage over-investment in fossil fuel industries. The incentives are inconsistent with the Administration's support of a clean energy economy that would reduce our reliance on oil and cut carbon pollution. Specifically, this would provide additional tax credits for: investment in qualified property used in a qualifying advanced energy manufacturing project; the production of advanced technology vehicles; and medium- and heavy-duty alternative-fuel commercial vehicles. It would also modify and permanently extend the deduction for energy-efficient commercial building property as well as the renewable electricity production tax credit, while making it refundable; modify and extend the tax credit for energy-efficient new homes; and extend the credit for cellulosic biofuels.

Extend and modify employment tax credits, including incentives to hire veterans. The Administration proposes to permanently extend the Work Opportunity Tax Credit (WOTC) and the Indian Employment Credit, both of which expired at the end of 2013. Beginning in 2015, the Administration also proposes to:

- Expand the definition of disabled veterans eligible for the WOTC to include disabled veterans who use the GI bill to receive education or training starting within one year after discharge and who are hired within six months of leaving the program; and

- Modify the Indian Employment Credit by changing base year wages to the average of those costs in the prior two years, rather than using the current law base year of 1993.

ASK THE WEALTHIEST TO CONTRIBUTE THEIR FAIR SHARE TO BALANCED DEFICIT REDUCTION

Implement the Buffett Rule by imposing a new "Fair Share Tax." The Budget ensures that high-income taxpayers cannot use deductions and low rates on capital gains and dividends to pay a lower effective rate of tax than many middle-class families. The tax is intended to ensure that very high income families pay tax equivalent to no less than 30 percent of their income, adjusted for charitable donations. This is expected to raise $53 billion over the next 10 years.

Limit certain tax expenditures for the most affluent by capping their value at 28 percent. The Administration proposes to limit the tax rate at which upper-income taxpayers can use itemized deductions and other tax preferences to reduce tax liability to a maximum of 28 percent. This limitation would reduce the value to 28 percent of the specified exclusions and deductions that would otherwise reduce taxable income in the top three individual income tax rate brackets of 33, 35, and 39.6 percent. This proposal is estimated to raise $598 billion over 10 years.

Restore the estate, gift, and generation skipping transfer taxes to 2009 levels. The Administration believes that the American Taxpayer Relief Act of 2012 tax cuts that were provided to the most affluent taxpayers were excessive, and the estate tax should raise an appropriate amount of revenue. The proposal would make permanent, after 2017, the estate, generation-skipping transfer, and gift tax parameters as they applied during 2009. This proposal would raise $118 billion over the next 10 years.

CLOSE UNFAIR TAX LOOPHOLES

Tax carried interest profits as ordinary income. Current law provides that an item of income or loss of the partnership retains its character and flows through to the partners, regardless of whether the partners received their interests in the partnership in exchange for services. Thus, some service partners in investment partnerships are able to pay a 20-percent long-term capital gains tax rate, rather than ordinary income tax rates on income items from the partnership. The Administration would tax as ordinary income a partner's share of income on an "investment service partnership interest" (ISPI) regardless of the character of the income at the partnership level. In addition, the partner would be required to pay self-employment taxes on such income, and the gain recognized on the sale of an ISPI that is not attributable to invested capital would generally be taxed as ordinary income, not as capital gain. This proposal would raise $14 billion over 10 years.

Eliminate a depreciation benefit for corporate jets and other general aviation passenger aircraft. Under current law, airplanes used in commercial and contract carrying of passengers and freight generally are depreciated over seven years. Airplanes not used in commercial or contract carrying of passengers or freight, such as corporate jets, generally are depreciated over five years. The Budget proposes to increase the depreciation recovery period for general aviation airplanes that carry passengers to seven years. Eliminating this benefit would raise $3.2 billion over 10 years.

Impose a financial crisis responsibility fee. Currently, there is no sector-specific federal tax that applies to financial firms. However, there are a range of fees, such as the fees assessed by the Federal Deposit Insurance Corporation to cover the cost of insuring deposits. The Administration proposes to impose a fee on U.S.-based bank holding companies, thrift holding companies, and certain broker-dealers, as well as companies that control insured depositories and certain broker-dealers, with assets in excess of $50 billion. U.S. subsidiaries of international firms that fall into these categories with assets in excess of $50 billion would also be covered. This proposal is expected to raise $56 billion over 10 years.

Modify "Like-Kind" exchange rules for real property. Under current law, capital gain or loss is generally recognized when capital assets are sold or exchanged. However, no gain or loss is recognized when business or investment property is exchanged for "like-kind" business or investment property. As a result, the tax on capital gain is deferred until a later realization event, provided that certain requirements are met. The Administration proposes to limit the amount of capital gain deferred from the exchange of real property to $1 million (indexed for inflation) per taxpayer per taxable year. This would raise $18 billion over the next 10 years.

PROMOTE GROWTH AND INNOVATION WHILE SUPPORTING JOB CREATION AT HOME, AS PART OF A RESERVE FOR BUSINESS TAX REFORM

Enhance the research and experimentation (R&E) credit and make it permanent. The Budget proposes to enhance the R&E tax credit by increasing the credit rate for the alternative simplified credit from 14 percent to 17 percent and making the credit permanent to encourage innovation and reward businesses that continue to invest in research projects. Making the credit permanent would remove uncertainty about whether the R&E credit will be extended, giving businesses greater confidence to invest in innovation that creates jobs in the U.S.

Establish tax incentives for locating jobs and business activity in the U.S. and prohibiting tax deductions for shipping jobs overseas. The proposal would make the U.S more competitive by creating a tax incentive to bring offshore jobs and investments back home, while reducing incentives to ship jobs overseas. Specifically, the proposal would create a new general business credit against income tax equal to 20 percent of the eligible expenses paid or incurred in connection with insourcing a U.S. trade or business, and would disallow deductions for expenses paid or incurred in connection with outsourcing a U.S. trade or business.

Increase the amount of deductible new business expenditures for small businesses. Under current law, a taxpayer may elect to deduct up to $5,000 of start-up expenditures and up to $5,000 of organizational expenditures in the taxable year in which the active trade or business begins, and to amortize the remaining amount. The proposal would permanently allow up to $20,000 of new business expenditures to be deducted in the taxable year in which a trade or business begins and would amortize the remaining amount ratably over the 180-month period beginning with the month in which the business begins.

REDUCE INCENTIVES TO SHIFT INCOME AND ASSETS OVERSEAS

Restrict Interest expense deductions for foreign and U.S. multinationals. Claiming deductions for interest is one of the simplest techniques for eroding the U.S. tax base. Current rules allow U.S. and foreign multinational corporations to disproportionately locate borrowings in the U.S. in order to use deductible interest payments to reduce U.S. taxes. To address this problem, the Administration has two proposals to restrict the amount of interest expense that U.S. and foreign multinationals can deduct against their U.S. operations:

- Defer the deduction of interest expense allocable to stock of foreign subsidiaries to the extent the income of such subsidiaries is deferred until it is repatriated; and
- Address over-leveraging of a foreign-parented group's U.S. operations relative to the rest of the group's operations by limiting U.S. interest expense deductions to the amount of the U.S. subgroup's interest income plus the U.S. subgroup's proportionate share of the group's net interest expense.

Restrict the ability of multinational firms to create "stateless income." Multinational firms do not just use tax loopholes to shift profits to low-tax countries; they now exploit inconsistencies between U.S. tax law and tax law in foreign countries to avoid paying tax anywhere, creating so-called "stateless income." The Budget includes new rules addressing these forms of tax arbitrage, for instance by limiting the use of "hybrid" corporate forms to create stateless income.

Update rules for digital goods and services. Many U.S. tax rules were written long before the rise of internet commerce and rely on distinctions that have lost their significance in a digital economy. These out-of-date laws allow multinational corporations to avoid U.S. taxes on U.S. profits, often simply by relabeling a transaction without affecting its content. For example, a company may be able to avoid U.S. tax by licensing software to an offshore affiliate in a low-tax jurisdiction, which in turn sells the resulting product to consumers, as opposed to selling from the U.S. directly to consumers.

Close loopholes in the international tax area.
These include:

- Tax gain from the sale of a partnership interest on look-through basis (raises $2.8 billion);
- Prevent use of leveraged distributions from related corporations to avoid dividend treatment (raises $3.5 billion);
- Extend section 338(h)(16) of the Internal Revenue Code to certain asset acquisitions (raises $1 billion);
- Remove foreign taxes from a section 902 corporation's foreign tax pool when earnings are eliminated (raises $0.4 billion); and
- Prevent avoidance of foreign base company sales income through manufacturing service arrangements (raises $24.6 billion).

Limit shifting of income through intangible property transfers. Under current law, there is a lack of clarity regarding the scope of the definition of intangible property that applies for purposes of taxing outbound transfers of intangible property by a U.S. person to a foreign corporation and the allocation of income and deductions among related taxpayers. These rules are intended to prevent inappropriate shifting of income from the U.S. to low- or no-tax jurisdictions. The proposal would provide that the definition of intangible property for these purposes also includes workforce in place, goodwill, and going concern value, and any other item owned or controlled by a taxpayer that is not a tangible or financial asset and that has substantial value independent of the services of any individual.

Limit the ability of domestic entities to expatriate. If an inversion transaction occurs, certain adverse tax consequences apply depending upon the level of continuing ownership of historical shareholders of the U.S. corporation in the foreign corporation. If the continuing ownership level is 80 percent or more the foreign corporation is treated as a domestic corporation for all U.S. tax purposes, and if the continuing ownership level is at least 60 percent but less than 80 percent, the foreign status of the foreign corporation is respected but other penalties apply. Because domestic entities have with greater frequency been combining with smaller foreign entities in transactions in which the shareholders of the domestic entity own less than 80 percent but greater than 60 percent of the foreign corporation, the Administration proposes to reduce the 80-percent shareholder continuity threshold for domestic corporation status to a greater-than-50-percent threshold, and to eliminate the 60-percent threshold. The Administration also proposes to provide that, regardless of the level of shareholder continuity, an inversion transaction can occur if the affiliated group that includes the foreign corporation has substantial business activities in the U.S. and the foreign corporation is primarily managed and controlled in the U.S.

PROTECT OUR MOST VULNERABLE CITIZENS

Allow conversion of private activity bond volume cap into Low-Income Housing Tax Credits (LIHTCs). States often have a larger number of deserving projects than they can support within the limit of their LIHTC ceiling. Although bond-derived credits can support the development of some buildings, other buildings can be built only with the higher credit rates that are available with allocated credits. The proposal would give States flexibility to increase their LIHTC ceiling by utilizing some of their private activity bond volume cap.

Require LIHTC-supported housing to protect victims of domestic abuse. The Violence Against Women Reauthorization Act of 2013 (VAWA) requires that housing that is assisted under a "covered housing program" must provide certain protections to any applicants or tenants that are or have been victims of domestic abuse, but it did not amend the LIHTC provisions in the Internal Revenue Code to facilitate this. The proposal would implement the intent of VAWA by requiring that protections for victims of domestic abuse be required by all long-term use agreements. Any prospective, present, or former occupant of the building could enforce these provisions of an agreement in any State court.

OTHER INITIATIVES

Provide for reciprocal reporting under the Foreign Account Tax Compliance Act (FATCA) to help stop offshore tax evasion. The U.S. has established a broad network of information exchange relationships with other jurisdictions based on established international standards. A jurisdiction's willingness to share information with the U.S. often depends on our willingness and ability to reciprocate by exchanging comparable information. This proposal would require certain financial institutions to report the account balance for all financial accounts maintained at a U.S. office and held by foreign persons. The proposal also would expand the current reporting required with respect to U.S. source income paid to accounts held by foreign persons to include similar non-U.S. source payments. The Secretary would be granted authority to issue Treasury regulations to require financial institutions to report additional information necessary to carry out the purposes of the proposal (such as the substantial owners of certain passive entities).

Address taxpayer identity theft. The Budget makes three separate proposals to reduce the likelihood of taxpayer identity theft and to increase penalties on those who engage in it. These initiatives will help the Internal Revenue Service (IRS) continue to increase its efforts to curtail identity theft and provide taxpayers with quality, effective service while safeguarding taxpayer information.

Stagger tax return filing due dates. This proposal moves up the filing deadlines for certain information returns and returns filed by partnerships to allow the IRS to conduct third-party information return matching earlier in the filing season and to give individual taxpayers more complete information before their individual income tax returns are due. Accelerating the taxpayer's receipt of third-party information will reduce burden on taxpayers by providing them with more complete information when preparing their original returns and potentially reduce the number of amended returns filed by taxpayers.